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1986 ECONOMIC POLICY AND OUTLOOK for AGRIBUSINESS

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PURPOSE

A. Present some information and use economic principles to:

1. help you better understand the economic environment within which you operate

2. develop some insights into how your markets are affected by public policies

3. anticipate the kinds of economic events that may affect your business in the months ahead, and

4. help you find a way to make a few extra bucks.

SLIDE 1: ECONOMIC POLICY AND OUTLOOK FOR 1986

A. Economic relationships have changed in ways that have significant impacts on the agricultural sector.

1. Macro economic policies of both the U.S. and foreign countries have become dominant factors in the U.S. farm economy

2. Agricultural policies of other countries have become more important to the economic prospects of U.S. agriculture and agribusiness than is domestic farm policy

3. Changes in financial market conditions are as important as are changes in the price prospects for farm commodities

4. Incomes of people living on farms are now more dependent upon employment in the nonfarm sector than on farm income

5. Farming is becoming increasingly divided between those who:

   a. operate the farm as a profit-seeking business (e.g., commercial farms), and

   b. are rural residents that enjoy farming as a way of life (e.g., hobby farms)

6. In many ways, agribusiness is more dependent upon economic swings in agriculture than are farmers

    a. or, at least those farmers in the latter category, above

    b. yet, farm policy continues to focus on the "family farm", a concept of uncertain meaning particularly in the economic context of the business of agriculture

B. These changes create new, complex and often confusing dimensions to the agricultural economy

1. Our efforts are aimed at broadening your understanding, and at some possible solutions for your consideration

C. Summary -- What we will say!

1. Overall, people are reasonably optimistic about the economy

    a. Consumer confidence has been quite high

    b. Unemployment has drifted down to a reasonably comfortable level

    c. Inflation has behaved better than most people expected

    d. Consumer spending has been sufficient to return the economy to a growth trend

2. But, there are a number of trouble spots in the economy

    a. The external sectors continue to fare poorly

        (1) imports continue to grow at a dramatic pace, giving rise to increasing calls for protectionism

        (2) exports continue to weaken, creating disequities in the labor market

    b. Credit markets are experiencing considerable uncertainty

        (1) The federal government continues to borrow vast sums to cover its operating deficit

        (2) the country's external debt is mounting

        (3) external debts of many developing countries are essentially uncollectible

        (4) real interest rates remain near record high levels

        (5) the ability to service the high agricultural debt is increasingly being questioned

c. Agriculture is suffering the double-whammy of a high debt burden and a declining foreign trade balance

(1) Foreign competition has increased dramatically

(2) Commodity markets are weighted down by record or near-record surpluses

(3) Wealth in the farm sector is rapidly eroding

(4) Financial stress among farmers has flooded over into the agribusiness sector

3. As usual, however, prospects differ among enterprises, individuals and firms.

QUESTION 1---<u>Expansionary monetary policy was largely responsible for the improved economy in late 1985 and early 1986, but at a cost of future inflation.</u>

SLIDE 2: GROSS NATIONAL PRODUCT

A. After a year of torrid economic growth in 1984, the rate of expansion of the U.S. economy slowed somewhat in 1985

1. GNP in nominal terms (current dollars)

a. 1985: +6%

b. 1984: +10.8%

c. 1983: +7.7%

2. GNP in real terms (deflated to 1972 dollars)

a. 1985: +2.5%

b. 1984: +6.8%

c. 1983: +3.7%

3. Inflation, after dropping significantly from the 1980 peak of 13.5% (CPI), has held surprisingly steady

a. 1985: 3.7%

b. 1984: 4.3%

c. 1983: 3.2%

4. Employment

a. 2.4 million jobs added in 1985, following 4.8 million in 1984

b. unemployment dropped to 7.0% from 7.5% in 1984, 9.5% in 1982 and 1983

5. 1985 growth was paced by:

a. government spending, up 9.1%

b. consumer spending, up 7.1%

6. Only a modest, 3.1% growth in new business investment

a. followed a dramatic 35% jump in 1984

b. was held down by

(1) a decrease in plant utilization rates

(2) continued increase in "off shore" investment where both labor and capital costs are lower

(3) a 10% decline in after-tax business profits, due in part to aggressive foreign competition

7. A record large trade deficit ($88 billion) has also been a drag on the economy

B. For 1986, a 4 trillion dollar economy is projected

1. Growth (in nominal terms) about matching 1985

2. Inflation is expected to nudge up above 4% again

SLIDE 3: FEDERAL BUDGET AND DEBT

A. The most important factor behind the recovery from the 1980-82 recessions has been stimulative federal fiscal policy

B. About $200 billion per year spent in excess of income since 1983

1. is pushing the federal debt rapidly toward $2 trillion

2. a large share of this debt is held by foreigners (approximately $200 billion)

a. beginning in 1983, inflow of foreign capital has exceeded outflow of U.S. investment abroad

b. U.S. is now a net debtor nation

3. Thus, a significant share of the U.S. economic growth over the past 3 years has been financed by foreigners

a. which reduces the funds they have left to spend on things, including U.S. goods

C. Note the impact of tax cuts in 1981 on revenues

D. Federal deficit projected at $200 billion or more for next several years

1. Question is: how will it be financed?

2. Alternatives are:

a. keep borrowing from foreigners (drives up both interest rate and value of dollar)

b. expand the money supply (inflationary)

3. Or, cut the deficit by

a. reducing growth in expenditures

b. increasing taxes

c. either way, stimulus for economic growth that comes from "double spending" of the deficit is removed, pointing to slower growth

SLIDE 4: GNP FOR 1986/85

A. For 1986, the federal budget deficit is pretty well set in concrete

1. Thus, another year of stimulation should keep the economy growing at a respectable pace

B. The big cloud continues to be foreign trade

1. Another trade deficit in the $100 billion range seems likely

2. Despite some easing in the dollar's value, it is still 20-30% overvalued relative to foreign trade equilibrium

C. The hidden enemy in the longer term is inflation

1. Monetary relaxation which began in 1985 to ease interest rates eventually will generate inflationary pressure

2. The easing of the dollar, particularly vis-a-vis the currencies of other industrial countries, will raise the price of imported goods (for which the nation has developed a gigantic appetite)

ANSWER 1: AGREE

QUESTION 2 --- <u>U.S. agriculture has lost its competitiveness in world markets</u> since 1981

SLIDE 5: WORLD GRAIN PRODUCTION AND USE

A. First, let's look at the world production and use situation

1. Food grains, feed grains and oil seeds account, directly or indirectly, for about 75% of human nutrition around the world

2. This slide tells much about world food markets

B. Years when use exceeds production (1977, 1980, 1983)

1. World stocks are being depleted

2. World market prices rise

C. Years when production exceeds use (1976, 1978, 1981, 1982, 1984, 1985):

1. World stocks are being built

2. Prices decline

3. The most serious pricing problems occur when stocks are building over 2 or more years (1981-1982, 1984-1985)

D. Note the upward trend in use (consumption), broken in 1981

1. World-wide recession, brought on by the U.S. switch from an expansionary to restrictive monetary policy, caused a reduction in buying power (income)

2. Since 1982 growth in both income and food consumption have returned

a. but, with a gap between the trend line consumption of the 1970s and the 1980s

b. it was that gap, set off in 1981, that caused a slow-down in world agricultural trade

c. however, world trade has trended upward since 1982, with the return to growth in world use

SLIDE 6: U.S. AGRICULTURAL EXPORTS

A. Wheat, soybeans and feed grains account for 85-90% of U.S. agricultural exports

B. The decline in U.S. farm exports began in 1981

1. Corresponded with the decline in world food consumption

C. However, the decline has continued since then

1. even though world use (and trade) has turned up

2. the obvious conclusion is, the U.S. has lost market share, e.g., competitiveness

	U.S. Share of World Market (%)		
	Corn	Wheat	Soybeans
1981-82	74	44	86
1982-83	74	38	86
1983-84	72	35	77
1984-85	66	34	69
1985-86	62	30	72

SLIDE 7: U.S. AGRICULTURAL EXPORTS

A. This slide shows, by class of commodity, export sales as a share of total cash receipts to the producers of these commodities

B. The rapid increase in the relative importance of export sales during the 1970s is obvious

   1. as is the decline since then

C. Also notice the large relative importance of export sales as a source of cash receipts for growers of our principle crops in Ohio--corn, soybeans and wheat (about 55-60% of cash receipts to Ohio farmers)

1. Thus, the Ohio agricultural economy is particularly dependent upon exports

D. A major issue is, what is the cause of our loss of competitiveness?

SLIDE 8: AGRICULTURAL TRADE AND THE VALUE OF THE DOLLAR

A. The direct relationship between the value of the dollar and agricultural trade is obvious

   1. A declining dollar (early, late 1970s) lowers the effective price of U.S. exports and raises that of imports

   2. A rising dollar (early 1980s) has the opposite effect

   3. These are fairly rapid responses

B. However, there is also an indirect relationship that is more long-term in nature

   1. This is the impact that dollar exchange rates have on agricultural production in other countries

   2. Because of the dominant share U.S. corn, soybeans and wheat have in world markets, a strong dollar has the effect of raising the world price level for these commodities

a. these higher world prices encourage other countries to expand agricultural production

b. high guaranteed domestic prices are used as production incentives

(1) the cost of such price guarantees is low when world price levels are high

c. as other countries expand production in response to high prices, some who were importers become exporters

(1) i.e. the European Community, China, India

d. these countries dispose of their surpluses by subsidizing their sale in the export market

(1) thus, increasing the competition faced by the U.S.

e. the higher the U.S. drives world price, the less costly it is for other countries to pursue such policies

3. There has been considerable debate over which has the biggest impact--the U.S. dollar or U.S. support prices (loan rates)

4. Our studies show that, based on 22 years of data, the U.S. share of world grain markets is about 5 times more sensitive to changes in the exchange rate than to changes in the loan rate.

SLIDE 9: VALUE OF THE U.S. DOLLAR

A. This shows changes in the average cost of the U.S. dollar to foreign buyers of our corn and soybeans, weighted by market shares of each of the major importing countries.

B. The dollar has stabilized somewhat recently

1. More so for soybean customers than for corn

2. A larger share of soybean exports are sold to industrialized countries who have stronger currencies than the less industrialized nations

C. Despite the recent stabilization, the dollar still costs 100-150% more, on average, than it did during its cheapest days in 1979-80

1. Thus, U.S. prices would have to be cut by one-half or more simply to keep effective world prices for U.S. corn and soybeans at 1979/80 levels

2. This would be roughly $1.40 for corn and $3.50 for soybeans

SLIDE 10: GRAIN YIELDS: U.S. VS. NON U.S.

A. Except for corn, notice that U.S. yields have declined relative to yields in the rest of the world since 1965.

B. This shows, in part, the impacts of greater production incentives around the world.

1. Acreages have also responded in a similar matter

C. It is a long term process to reverse these trends even if the dollar declines, making it more costly to maintain such production incentives

1. Thus, it is unlikely that the U.S.'s competitive position will quickly be restored even if (or when) the dollar declines appreciably

SLIDE 11: U.S. AGRICULTURAL EXPORTS AND FARM PRICES

A. This slide dramatically illustrates the relationship between U.S. agricultural exports and the value of U.S. farm products

B. With the U.S. population, and thus domestic food demand growing at less than 1% per year, the importance of the external market to the economic viability of U.S. agriculture is obvious

ANSWER 2: AGREE

QUESTION 3--Incomes to farm families have fallen dramatically.

SLIDE 12: DISPOSABLE PERSONABLE INCOME OF FARM AND NONFARM POPULATION

A. The slide shows that the per capita real DPI of the non-farm population has generally grown at a steady rate since the Depression

1. the compound growth rate was 2.1% per year from 1934-1985

2. exceptions to this steady growth include:

a. the upward "blip" due to WW II

b. the recession of 1979-1982

B. The DPI from all sources for the farm population grew at a faster rate--3.6 percent per year--than the DPI of the non-farm population over 1934-1985

1. However, the growth rate has varied significantly over time:

1934-1946	8.7%
1947-1959	-0.9%
1960-1971	6.1%
1972-1979	5.4%
1980-1985	-4.4%

2. The net result is that the farm population has gained relative to the non-farm population:

	Farm DPI/Non-Farm DPI
1934-1946	44%
1957-1959	49%
1960-1971	62%
1972-1979	91%
1980-1985	78%

C. The overall growth in farm DPI can be attributed in large part to two factors:

1. Non-farm sources of income have become increasingly important to the farm population.

   a. Non-farm sources of farm DPI grew at annual rate of 4.4% over 1934-1985, much faster than farm sources, which grew at an annual rate of 2.7%.

   b. In 1985, non-farm sources accounted for 62% of farm DPI. By comparison, non-farm sources averaged only 31% of farm DPI during 1930's and 1940's.

   c. The movement towards off-farm employment began in earnest during the late 1950's and early 1960's.

2. The second important factor was the decrease in farm population

   a. In 1934, the farm population was just over 32 million. By 1985, the farm population had dropped to just under seven million people

   b. The rate of decline in the farm population over 1934-1985 was 2.9 percent per year. The annual growth rate of <u>aggregate</u> farm DPI was only 0.1 percent per year. Thus, a relatively constant income was divided up among fewer and fewer farmers

D. Prospects for 1986 and beyond

1. Per capita farm DPI (all sources) is expected to grow three to four percent in nominal terms during 1986. Thus, in real terms farm DPI is expected to stay constant or increase slightly

2. Farm population decreases will accelerate due to financial problems. The decline during 1986 is expected to be in the range four to six percent.

3. Non-farm sources of DPI are expected to continue to contribute 60-70 percent of farm DPI

4. For the intermediate-run (three to five years), it is unlikely that farm DPI will attain the levels reached during the 1970's.
5. Problems may be especially acute for those relying totally on income from farm sources, which will likely be substantially below 1970's levels on a real per capita basis

6. In the longer-run (five to ten years), those surviving current financial problems will have to share the "income pie" with fewer farmers.

7. The real income pie is not likely to expand dramatically, however, because of the low income elasticity of food, slowing birthrates around the world, and increased competition from foreign producers.

SLIDE 13: PRICES FOR FARM INPUTS

A. Livestock Placements

1. Units

	1985/84	1986/85
Beef No.	-5-6%	-3-5%
Hogs No.	-2-4%	-1-2%
Poultry No.	+4-6%	+3.5%

2. Price

Beef	-8-10%	+2-4%
Hogs	-8-10%	+1-3%

B. Feed

	1985/84	1986/85
Animal Units	down	N/C
Feeding Rate	up	up slightly
Price	down	down

C. Seed

Acreage	down
Price	?

SLIDE 14: PRICES FOR PURCHASED INPUTS

A. Chemical prices have increased only moderately since 1977

1. Prices are expected to be constant or fall slightly during 1986

2. Chemicals will continue to be a good buy

B. Through 1983, interest rates increased faster than any other input price

1. Since 1983, interest rates have fallen about two percent

2. Nevertheless, interest payments continue to be in the range of $21-23 billion, compared to $8-10 billion in the late 1970's

3. Neither a large increase nor decrease in interest rates is foreseen for 1986

4. Non-competitive rates, however, will continue to be a problem for Farm Credit System borrowers due to loan losses.

C. Fertilizer prices in 1985 continued their moderate path of 1981 through 1984

1. Little change is expected in fertilizer prices in 1986 as production is cut back to match reduced demand

D. Machinery prices are expected to increase moderately during 1986

1. Watch for discounts as manufacturers attempt to move backlog of inventory

E. Taxes are not expected to increase markedly during 1986

1. Carry forward of losses will limit increases

F. Fuel prices were steady during 1985

1. Moderate price declines are likely in 1986 due to decreased use

2. If OPEC collapses and a crude oil "price-war" breaks out, significant price declines may occur

SLIDE 15: QUANTITY OF SELECTED INPUTS

A. Cropland has fluctuated around 1977 base of 345 million acres

1. In 1983, PIK reduced acreage 15% to below 295 million acres

2. Expect 1986 acreage to be reduced modestly from 1985 levels due to acreage reduction programs and reduced profits

B. Labor use is expected to continue to decline two to three percent per year

C. Fertilizer use has stabilized after the PIK-induced decline

1. during 1983 the index declined to 82

2. moved back to 95-100 in 1984 and 1985

3. modest increase in fertilizer use expected for 1986

D. 1985 was the sixth consecutive year that farmers purchased less machinery than the year before

1. Declines have been the most substantial for "big-ticket" items, i.e. combines and four-wheel drive tractors

2. U.S. farm machinery market currently has a 10-18 month supply of new tractors and harvesting equipment

3. Prospects for a turnaround in 1986 are dim; purchases may be down five to ten percent

E. Farm output continued to recover from the 1983 low during 1985

1. 1983 decline reflects PIK and drought

2. 1985 production will be only slightly lower than the record level of 1982

3. Surpluses in nearly all major crops

4. Historically, U.S. agriculture has increased productivity about 1.5 percent per year

5. Many believed productivity might slow in the 1970's and early 1980's, however, recent developments in biotechnology point toward higher, rather than lower, future rates of productivity growth

ANSWER 3--DISAGREE

QUESTION 4--DECLINING LAND VALUES HAVE LITTLE TO DO WITH THE FINANCIAL PROBLEMS OF THE FARM CREDIT SYSTEM

SLIDE 16: REAL VALUE OF U.S. FARMLAND

A. The chart shows the "roller coaster" ride of real, U.S. farmland prices since 1972

1. Starting with an index value of 100 in 1972, land prices increased rapidly to a high during 1980

a. real land prices increased 53% in only nine years

b. the increase was primarily a reaction to the extraordinary returns of 1973-74

c. based on data from 1910-1985, the 1973 return has less than a one in a 1000 chance of reoccurring

2. Between 1981 and 1985, the real increase in land values was erased

   a. as of April 1, 1985, the index value was 100, the same as it was on February 1, 1972

   b. the decline in value can be explained as a wearing-off of the return shock of 1973-1974

   c. this was reinforced by lower than expected returns during the early 1980s, and dramatically higher real interest rates

SLIDE 17: CORN BELT FARMLAND VALUES

A. The charts shows that four cornbelt states--Ohio, Indiana, Illinois, and Iowa--have experienced an even more dramatic "roller coaster ride" with respect to real land values

1. Real $ Change

	1972-1981	1981-1985
Ohio	+379	-404
Indiana	+471	-444
Illinois	+454	-494
Iowa	+478	-502

   a. Ohio, Illinois, and Iowa real land values in 1985 were lower than in 1972

   b. Illinois had the highest value at the peak in 1981; Ohio had the lowest peak value

   c. Iowa land values increased the most; the increase was $100 per acre more than in Ohio

   d. Iowa land values have declined the most; the decline was almost $100 per acre more than in Ohio

2. The chart does not reflect the continued deterioration in land values during the latter half of 1985

   a. Surveys suggest an additional real decline of 5-10%

3. Further declines are expected for 1986. However, the magnitude may be much smaller

   a. Declines for 1986: -5-8%

B. The decline in land values undermines the credit-worthiness of the farm sector

1. At the beginning of 1985, equity in farm sector assets, adjusted for inflation, was off 33% from the 1980 peak and the lowest since 1973

2. For highly leveraged farmers who are simultaneously faced with cash flow shortages, the erosion in equity has undermined the value of collateral that secures their debt and accelerated the number of farmers headed toward technical insolvency

   a. because highly leveraged farmers owe a proportionately large share of outstanding farm debt, financial problems have extended to farm lenders

   b. as of January 1985, the USDA estimated that the five percent of U.S. farms experiencing the most severe financial problems (debt/asset greater than or equal to 70% and negative cash flow) hold 23% of outstanding farm debt.

3. Financial problems are especially acute for the Farm Credit System, which has 90% of its loan portfolio invested in agriculture

   a. by comparison, the roughly 5,000 private "agricultural" banks in the U.S. have only 37% of their total loans invested in agriculture

      1) nonfarm loans are generally performing well, so the incidence of a lender's problem is directly proportionate to the degree of specialization in farm lending

   b. FCS problems are compounded by the fact that two-thirds of its approximately $80 billion in outstanding loans are held by the Federal Land Bank System.

SLIDE 18: PROBLEM LOANS AND FINANCIAL RESOURCES OF THE FARM CREDIT SYSTEM

A. The charts show estimates made by the Agricultural Economics staff at OSU of the problem loans and financial resources of the FCS

   1. The estimates of problem loans <u>were not</u> based on FCS data, due to the unavailability of such information

   2. Problem loan estimates were based on data from a recent USDA survey of the financial condition of U.S. agriculture

      a. Estimates must be used with caution because actual FCS problems may be more or less severe

B. Problem loans of the FCS:

	(Billions)
Extreme Risk	7.74
High Risk 8.97	
Moderate Risk	17.10
Total	33.81

1. The estimates suggest that over 40% of the loan portfolio of the FCS may be asssociated with financially stressed farmers

2. However, in the event of voluntary restructuring, bankruptcy, or foreclosure, the FCS will not lose the entire face value of troubled loans

   a. OSU estimates of potential losses:

Loan Category	Amount(bil.)	Loss(%)	Loss (bil.)
Extreme Risk	$ 7.74	50%	$3.87
High Risk	$ 8.97	33%	$2.96
Moderate Risk	$17.10	10%	$1.71
Total			$8.54

   b. the loss estimates are very subjective and depend on the percent loss assumed. Due to the "ballpark" nature of the estimates, actual losses will likely be substantially different

C. FCS financial resources:

	(Billions)
Loan loss allowance	$ 1.2
Member-owned capital	$ 5.9
Earned surplus	$6.3
Total	$13.4

1. It is unlikely that the entire $13.4 billion of resources will be available to offset losses

   a. use of member-owned capital may make financial conditions worse

   b. this leaves only $7.5 billion to offset losses, suggesting it will be difficult for the FCS to continue as a viable lending vehicle without governmental assistance

2. There is legitimate concern that liquidation of farmers' assets, in order to pay debts, may overwhelm asset markets, especially real estate.

   a. for instance, only about 3% of farm real estate assets are bought and sold annually

   b. this suggests that even with strong markets, it would take nearly four years to complete the transfer of the roughly 11% of U.S. farm sector assets, that need to be transferred from the most financially farmers to financially strong owners

   c. it should be noted that farm debt constitutes only three percent of total private and public sector debt in the U.S.

   d. thus it is very unlikely that a worsening of the farm credit problem will lead to a toal callapse of the financial system

SLIDE 19: FARM CREDIT POLICY ALTERNATIVES

A. Several different types of government programs have been proposed. Some would assist all farmers, others would be targeted to FCS borrowers only

   1. Debt moratoria

      a. this alternative would deny the use of foreclosure procedures against farmers who cannot make interest and principal payments or would:

         1) cancel or defer interest and principal payments for a specified period

         2) write down a portion or all of the debt

         3) deny deficiency judgements for those who cannot make payments
         4) combinations of the above

      b. most debt moratorium proposals include a limited period in which debt obligations need not be met, but they <u>do not</u> eliminate the commitment to repay debt eventually

      c. a key to the success of debt moratoriums is that financial conditions of agriculture improve

      d. the major cost of debt moratoria is the income forgone by lenders during the moratorium period

      e. a long-run concern is that a moratorium would force bankers to charge higher interest rates in the future to offset the risk of future credit disruptions

   2. Deferral of interest and/or principal payments

a. objective is to lower immediate debt service costs by re-amortizing loans over an extended period of time

b. the premise of this approach is that providing additional time to repay would allow farmers to rearrange the financial structure of their businesses

3. Loan guarantee

a. essentially what FmHA has been doing on all of its non-direct operating loans and many of its long-term loans

b. basic principle is to guarantee repayment of most (FmHA = 90%) or all of principle and lost interest to lender in case of default

c. will not reduce debt service cost, but can result in a credit extension to a farmer who would not otherwise receive a loan

d. without other programs to reduce the debt service cost to farmers, a loan guarantee program might be perceived as simply a "lender bailout"

4. Objective or principal buy down

a. interest is to reduce debt service costs by lowering either the loan principle or interest rate or both

b. lender typically has to agree to write down a portion of the principle or interest rates for the length of the loan

c. lender may be offered a guarantee or swap of government securities for remaining portion of the loan

d. government may provide a direct interest-rate subsidy

5. Other alternatives

a asset leasebacks

b. marketable federal income tax credits

c. recapitalization programs

d. agricultural land holding corporation

ANSWER 4--DISAGREE

QUESTION 5--<u>Farm Commodity policy will be designed to reduce both production and cost to the federal treasury</u>

SLIDE 20: U.S. FARM POLICY...OBJECTIVES

A. There is always a certain uncertainty about farm policy

   1. But, this turns into a very large uncertainty when developing discussion notes at a time when there is not--but soon will be--a farm bill

B. Numerous objectives can be--and are--put forward for U.S. farm policy

   1. These are not always consistent with each other

   2. The political process is used to resolve inconsistencies in policy objectives

      a. the greater the inconsistencies, the greater the difficulty in obtaining a politically acceptable compromise

      b. this is much of the explanation for why getting a 1985 farm bill has been so arduous

C. Some of the most frequently mentioned objectives include:

   1. Supporting farm income

      a. this is generally put forward in the sense of creating parity between the incomes of farm and nonfarm people

      b. one complexity is that wealth is difficult to handle

         (1) income streams to farmers typically become capitalized into asset (usually land) values

         (2) this increases farmers wealth positions but often cuts into current income as greater expense is involved in obtaining the more valuable asset

         (3) thus, parity of incomes between capital intensive industries (such as farming) and others is virtually impossible to maintain without factoring in wealth

         (4) yet, wealth doesn't pay the bills

   2. Sufficient but not excessive supplies

      a. this is the matter of assuring adequate food supplies without building surplus stocks that persistently depress prices to unprofitable levels

      b. in part, it reflects the goal of balance between low cost food and acceptable farm incomes

   3. Export competitiveness

      a. this objective deals with maintaining or expanding U.S. agriculture's share of world trade

b. related policy variables include:

(1) loan rates--are these so high as to price U.S. products out of world markets?

(2) export promotion

(3) export financing and credit programs

(4) contract sanctity

(5) cargo preference rules

4. Stewardship of natural resources

a. the conservation ethic: protecting our base of natural resources for future generations

b. the externality issue: protecting our base of natural resources for down-stream users

c. the production adjustment perspective: reducing the production of market surpluses in the name of resource conservation

5. "Family farm" agriculture

a. many view the purpose of farm policy to maintain or strengthen a system of family farm agriculture

b. there are many different views as to what is family farm agriculture

(1) some take this to be small-holder agriculture, where a single family provides the labor, management and capital and receives most (if not all) of its economic sustenance from the farm

(2) others take a more Jeffersonian free-holder view, where the ownership and control of the farm business rests predominantly with a family as an entrepreneurial unit

c. despite conflicting or inconsistent views as to what is a family farm, most farm bills include a preamble extolling its virtues

6. Equity and fairness

a. most farm programs redistribute income, at least from taxpayers to farmers (or some farmers)

b. but there is a general perception that such income redistribution should be "fair"

c. in practice, however, it is generally easier to determine what is not fair (e.g., million dollar payments to farms owned by USDA program administrators) than what is fair

7. Limited federal budget exposure

SLIDE 21: COST OF THE 1973, 1977 AND 1981 FARM BILLS

A. This slide provides a visual representative of why the cost of farm policy is of increasing concern

B. During the life of the 1981 farm bill (1981-1985)

1. All federal government spending increased 47.3%

2. Outlays for USDA programs, including farm policy, increased 73.5%

SLIDE 22: U.S. FARM POLICY...ISSUES

A. Cost to the federal treasury

1. Obviously, cost-containment is an important consideration in light of:

a. the rapid cost acceleration during the 1981 farm bill

b. the mounting federal deficit

c. the sense of unfairness associated with payments to farmers averaging nearly $28,000 annually

2. But, this concern appears to have been overridden by Congress' desire to provide financial assistance to the farm community

B. Loan rates

1. The traditional concept has been "no recourse" by the lender (CCC) if the farmer fails to repay and forfeits the commodity

a. this essentially establishes a minimum market price at around the loan rate

b. problems occur when loan rates are above market-clearing price levels

(1) forfeitures increase

(2) raises the cost to the government, because loans become budget outlays

(3) results in accumulation of government held stocks

c. much debate over the appropriate loan rate levels

(1) in the 1985 farm bill, loan rates are likely to be tied to a certain percentage (e.g., 75-85%) of historic market prices

2. A new price support loan concept proposed--the marketing loan

a. basic idea is, the CCC loan would be discharged by selling at the market price, even if below the loan rate

b. government payment would be the difference between loan and market price, if the latter is lower

c. major advantage is, the loan rate doesn't set the minimum market price, but does provide minimum price protection to the producer

(1) thus, market can clear, and stocks are not accumulated

d. major disadvantages

(1) costly to the government if prices are below loan

(2) market prices would be disrupted by dumping at loan maturity

(3) does not resolve the debate over "appropriate" loan rates

C. Target Prices

1. The major issue: what level?

2. Probable in the 1985 farm bill: freeze for at least 2 (possibly 4) years at 1985 levels

a. corn = $3.03

b. wheat = $4.38

D. Acreage, production controls

1. Major debate between:

a. continuation of voluntary acreage reductions and set-asides, or,

b. mandatory quotas based on historical production

2. Basic philosophy is to cut production in order to raise market prices

3. Voluntary approach is most likely

a. unpaid 10-20% diversion as a condition of eligibility for program benefits

b. authorization for diversion payments on an additional 10-15% when needed to balance supplies

E. Soil, Water Conservation

1. Sodbuster approach

a. withholds program benefits to anyone who plants row crops on "fragile" land (e.g., highly erodable)

2. Cropland conservation reserve

a. a bid system for long-term land retirement

b. has the double benefits of soil conservation and reduction in crop acreage

F. Export Promotion

1. Much agreement that export promotion policies should be included in the farm bill

a. less agreement on specific policies

2. Most frequently discussed options

a. export PIK/green dollar program

b. short, intermediate and long run credit programs

c. export subsidies

d. exemption from cargo preference rules

e. efforts to reduce trade barriers

f. expanded funding for commodity promotion abroad

G. Grain Reserves

1. Biggest unknown is the renewal of the Farmer Owned Reserve (FOR)

a. in concept, this is a useful program to limit both extreme peaks and dips in market prices

b. in practice, its been difficult to manage and expensive to operate

2. Most likely the FOR will not be renewed

a. may be a modest "emergency food reserve" established in its place

H. Payment Limitations

1. This speaks to both the objectives of cost and fairness

2. Current limit of $50,000 per producer is likely to be extended, or perhaps reduced somewhat

ANSWER 5--AGREE

SLIDE 23: SUPPLIES AND PRICES: 1985--WHAT WE SAID!

A. Our record: 5 out of 7 (.714 average)

1. We, along with nearly everyone else, badly missed price projections on cattle and hogs

a. we predicted small increases

b. significant declines actually occurred

(1) hog prices were down about 9% from 1984 and about 11% below our projected levels

(2) cattle prices were down about 10% from 1984 and about 13% below our projections last year

2. For the other commodities, things came out reasonably close to our expectations

QUESTION 6--Milk production is "surging to unprecedented heights" even with declining prices.

SLIDE 24: MILK PRODUCTION, COWS, AND MILK PER COW

A. Milk production in 1985 rebounded sharply from the 3% cut in 1984

1. 1985 Output = 141.5 billion lbs., up 4.5%

2. 1984 Output = 135.4 billion lbs., down 3.1%

a. a major factor in the 1984 cut was a 2.3% decline in cow numbers

b. this was a direct result of the milk diversion program that was in effect from Jan. 1, 1984 through March 31, 1985

B. Several factors are involved in the 1985 increase

1. A large build-up of high quality dairy replacement heifers during the diversion program

2. A "race for base" as dairymen anticipate a new diversion or production quota system tied to historical production levels.

3. A significant 3% jump in average per-cow production, due to

   a. high quality herd replacements

   b. heavy culling of low-performance cows during the diversion program

   c. a favorable milk-feed price ratio

SLIDE 25: MILK PRICES AND FEED PRICES

A. the decline in feed costs in 1985 paralleled the decline in milk prices

B. This has held the milk-feed price ratio steady through 1985, even though pay prices for milk in late 1985 are about $1/cwt. below a year earlier

SLIDE 26: OHIO MILK PRICES

A. Prices have come under significant downward pressure

   1. Blend prices (3.5 BF) averaged about $12.30/cwt. in late 1985

      a. minus the 15 cent/cwt. assessment for market promotion

   2. This is down from the $13.25 average in 1984, less the 50 cent/cwt. assessment to pay the cost of the diversion program

B. Price decline reflects a cut in the price support level from $12.60 during 1984 to:

   1. $12.10 on April 1, 1985

   2. $11.60 on July 1, 1985

C. Lower price support levels have been in response to sharply higher government purchases and costs

   1. CCC purchases, milk equivalent

	Bil. pounds
1982	14.3
1983	16.8
1984	8.6
1985	14.0

   2. Commercial demand has also increased, in part in response to lower prices

a. up 1% in 1985, to 128 bil. lbs.

b. but, not enough to absorb the 4.5% production gain

c. thus, generating the large government purchases

D. Price support will probably remain at $11.60 for most of 1986

1. This should hold Ohio farm prices at around $12/cwt.

2. Assuming that some sort of diversion program is implemented to restrain production

a. could include a whole-herd buy-out as well as a paid diversion

b. will probably be financed by another assessment, thus lowering effective returns to producers

3. If an effective diversion program becomes operational, e.g., cuts 1986 output by 4% (compared to 3% in 1984), then

a. 1986 output would drop to around 136 billion pounds

b. commercial demand should increase another 1% or so, to around 129.5 billion pounds.

c. this should cut government purchases by more than half, to around 6.5-7 billion pounds.

d. this would strengthen the Minnesota-Wisconsin pay price sufficient to add 50-75 cents to Ohio blend prices (above the $12 projected)

4. If a diversion program is not put in, look for mounting surpluses to force another cut in the support price--perhaps to $10.60--in the autumn of 1986

ANSWER 6 -- AGREE--but not for long!

QUESTION 7--Egg prices should strengthen in 1986 as demand increases.

SLIDE 27: CHANGE IN QUANTITY OF FOOD CONSUMED PER CAPITA

A. First, let's look at trends in domestic food consumption

B. A general trend over the past 15 years toward more plant products and less animal products in the typical diet

1. Per capita consumption of plant products since 1968 = +11%

2. Per capita consumption of animal products in same period = -8%

C. Reasons for this dietary change are not entirely clear, but probably include

1. Health concerns (i.e., cholesterol, animal fats)

2. Aging population

3. Demographic changes

4. More sedentary life style

5. Food advertising and merchandising

6. Others?

D. This change in eating patterns has profound implications for agriculture

SLIDE 28: LIVESTOCK: POULTRY CONSUMPTION PER CAPITA

A. Among the major categories of animal products are some very diverse trends

1. Both eggs and dairy products have shown a persistent downward trend

a. despite occasional upturns such as in 1979 for eggs and last year for milk and dairy products

2. Red meats, after showing irregular growth in the early and mid 1970s, appear to be on a general downward trend since about 1977

3. Poultry meat (mostly broiler chickens) is the most significant exception to the general trend

a. per capita consumption is up 45% since 1968 and 35% since 1975

b. total per capita chicken and turkey consumption in 1986 will reach 72 lbs.

(1) just shy of the 72-74 lbs. projected for beef

(2) well above the 60-61 lbs. of pork

B. Reasons for the shift away from other animal products to poultry meat include:

1. Health concerns

2. Relative prices

a. in 1977:

(1) average retail pork prices = 2.5 times broiler prices

(2) average retail beef prices = 3 times broiler prices

b. by 1985:

(1) pork prices averaged 3 times higher than broiler prices

(2) beef prices were nearly 5 times higher

3. Rapid adoption of chicken on restaurant menus

a. particularly at fast food restaurants

b. chicken is now the most frequent entree on restaurant menus

SLIDE 29: BROILER PRICES (DEFLATED) AND SUPPLY OF BROILERS PER PERSON

A. A popular myth is that the demand for chicken has increased

B. In reality, it appears that there has been little movement in the demand curve

1. That is, at a given real price, people do not appear to be consuming more chicken now than earlier

2. Rather, we have seen a rather persistent movement down the demand curve

a. people, on average, consuming more chicken

b. but at a declining real price

C. Whereas, the demand curves for most other categories of animal products, including eggs, appear to have shifted to the left

1. That is, at a given price, people consume less, or

2. For a given quantity, they are not willing to pay as much

SLIDE 30: RATE OF LAY, PROD., AND NUMBER OF LAYERS

A. Egg production has been cut-back in 1985 after increasing in 1984 in response to high prices associated with the Asian flu outbreak

1. 1984 hatch of layer replacements = +13%

2. 1985 hatch = - 21%

3. Cyclical peak in potential production, based upon layer numbers, was reached in May 1985

4. Rate of lay continued to increase in 1985, mainly due to:

a. a younger, more productive flock

b. lower feed costs which encourage more aggressive feeding

B. For 1986, production will decline through the first 3 quarters

1. The flock size will be down 2-3% due to this year's cut in the hatch

2. rate of lay will level out or decline as the average flock age lengthens

SLIDE 31: CARTONED EGG PRICES, N.Y.

A. Prices declined rapidly in early 1984 and were at generally unprofitable levels through late summer-early fall 1985

1. During the first half of 1985:

a. prices were 35% below a year earlier

b. output was up only about 1%

2. This suggests a substantially weaker-than-normal demand

a. normally, a 1% change in production is associated with a 5% change in price (in the opposite direction)

B. Prices have strengthened in late 1985 and should continue to improve through the first 3 quarters of 1986

1. Response to production cuts

2. Expect a more normal price-quantity response than in early 1985 when prices fell from the unusually high year-earlier levels

3. Thus the 2-3% cut in expected production during this period should result in prices averaging 10-15% above comparable 1985 levels

ANSWER 7--DISAGREE

QUESTION 8--<u>INTERNATIONAL TRADE IN PORK PRODUCTS IS A POSITIVE FACTOR FOR U.S. HOG PRICES</u>

SLIDE 32: PORT IMPORTS & EXPORTS

A. The graph shows imports and exports of pork products as a percent of U.S. commercial production.

1. Port imports have increased dramatically since 1981.

a. The largest increases occurred during 1984 and 1985, the same period when the dollar reached record levels.

b. For the January to May period of 1985, live hog imports from Canada increased 55% over 1984 levels.

c. Pork product imports from Canada and Denmark rose 30% from the same period of 1984.

d. Combining live hogs and pork products, total imports rose 35% for the first five months of 1985 to a level representing about 10% of U.S. commercial production.

2. Pork exports from the U.S. have not been substantial.

a. Nevertheless, the strong dollar has reduced pork exports from 2.3% of commercial production in 1981 to 0.9% for the first five months of 1985.

3. Net Trade Balance

	% of U.S. Commercial Production
1981	-1.2
1982	-3.2
1983	-3.6
1984	-6.9
1985*	-9.1

*Jan-May

a. The price effect of the worsened pork trade balance is not inconsequential: ~$4-5/cwt.

b. The outlook is for a modest reduction in the pork trade deficit into 1986, due to a weakening in the value of the dollar and the imposition of countervailing duties on live hog imports from Canada.

c. Total pork imports may decline 5% from 1985 levels.

SLIDE 33: HOG PROSPECTS

A. The slide presents information about how sow farrowings and profitability is measured by the hog-corn ratio.

Note: The Pig Crop heading on the table should be Sows Farrowing instead

1. The hog-corn ratio is the number of bushels of corn that equals the value of 100 pounds of pork.

a. Break-even ratio on average is about 20:1

b. The more the ratio exceeds 20:1, the faster the expansion in farrowings and vice versa.

2. The hog-corn ratio was below 20:1 during the breeding period for sows farrowing from December 1984 through August 1985.

a. In response to the poor profits at breeding, hog farmers reduced the number of sows farrowing.

b. The relationship between the hog-corn ratio and sows farrowing is not exact, yet it does yield important information about hog farmers' production intentions.

3. The hog-corn ratio for the latter half of 1985 inched closer to a profitable level.

a. The effect of heightened profit prospects was evident in the December 1985 - February 1986 farrowing intentions, which were only 1% lower than year ago levels.

b. Low corn prices will likely keep the hog-corn ratio near 20:1 for much of 1986.

c. Thus, a sharp reduction or expansion in sow farrowings is not expected.

B. Sow farrowings do not solely determine the size of the pig crop; the second component is the number of pigs-per-litter.

1. Pigs-per-litter

	1984	1985	1985/84
Dec-Feb*	7.27	7.51	+3
Mar-May	7.58	7.75	+2
June-Aug	7.60	7.73	+2
Sept-Nov	7.52		

*December of preceding year

a. The number of pigs-per-litter was a record for the March-May 1985 period.

c. The general rise in pigs-per-litter is due mainly to favorable weather during breeding and farrowing seasons and better management practices.

C. The increases in pigs-per-litter more than offset the smaller number of sows farrowing. Thus, the pig crop in 1985 has been larger than expected.

1. Pig Crop

	1984	1985	1985/84
Dec-Feb*	14,288	14,538	+2
Mar-May	18,814	18,762	0
June-Aug	17,158	16,941	-1
Sept-Nov	17,420		

*December of preceding year

2. Production prospects for 1986

a.

	1986-85
1986 I	Down 1-2%
1986 II	Down 1-3%
1986 III	Up 1-2%

b. If producers add pounds to average slaughter weights due to low feed costs, production may be up for all of 1986.

SLIDE 34: PORK PRICES (DEFLATED) AND SUPPLY OF PORK PER PERSON

A. The slide shows two approximate demand relationships for pork on a real per capita basis.

1. The line furthest to the right generally held true over 1960-1974.

2. The left line held approximately for 1975-1985.

a. 1979 and 1980 did not follow the new relationship.

b. The general leftward shift in the demand for pork in the late 1970s and early 1980s may be due to:

1) health and dietary concerns
2) aging population
3) geographic population shifts

3. If the demand schedule had not shifted, pork prices would have been 25-35% higher during 1984 and 1985.

4. An important question is whether the demand curve has shifted leftward again during 1984 and 1985.

a. the 1984 and 1985 observations may have been "random" deviations from the 1975-1985 relationship.

b. If demand had followed the 1975-1983 relationship precisely, pork prices would have been 8-12% higher.

SLIDE 35: HOGS: B & G AT 7 MARKETS

A. Late 1985 situation

1. Marketings may be down 3-5%

a. Mar-May pig crop was unchanged over 1984 levels

b. Inventory of 60-179 pound hogs on September 1 suggests producers may be expanding the breeding herd slightly.

c. Pork imports may decline from the peak levels experienced during the first half of 1985.

2. Price prospects

a. Fall '85 hog prices may average $43-46/cwt.

1) Less pork and beef

2) More poultry

b. Annual average for 1985 is expected to be $44-46/cwt.

B. 1986 price prospects

1. First half of 1985

a. 1-3% less port produced in U.S.

b. 3-5% less pork imports

c. less beef; more poultry

d. Prices are expected to average $45-49

2. Second half of 1985

a. Marketings may increase modestly

b. Breeding herd may also expand due to incentive of low feed costs

c. B & G prices may average $44-48

ANSWER 8--DISAGREE

QUESTION 9--ECONOMISTS HAVE ESTABLISHED AN ENVIABLE RECORD IN FORECASTING FED CATTLE PRICES

SLIDE 36: CATTLE SLAUGHTER WEIGHTS

A. Cattle prices for 1985 have been $10-$20/ cwt. lower than forecast by everyone, including economists, advisory services, and cattlemen themselves. Three factors are thought to be responsible for the lower than expected prices.

1. Live slaughter weights averaged 1101 pounds for the first nine months of 1985, 3.4% higher than year-ago levels.

a. The increase in slaughter weights was even more dramatic for the June-September 1985 period; average weights were up 4.3% compared to the same period in 1984.

b. Dressed weights were at record levels for much of the first nine months of 1985.

c. Contributing to the heavier weights was:

1) a shift in the slaughter mix as cow slaughter declined to 19% of total slaughter, down from 22% a vear earlier.

2) Futures prices and price forecasts showed premiums for later delivery and contributed to the reluctance to sell.

d. Despite the large increase in average weights, beef production under federal inspection through August was about the same as a year earlier.

SLIDE 37: FARM-RETAIL PRICE SPREADS: CHOICE BEEF

A. Relatively wide farm-to-retail beef margins were a significant factor in the lower than expected cattle prices.

1. Between December 1984 and June 1985, cattle prices were down 13.7%, wholesale beef prices declined 12.5%, but retail prices declined by only 3.5%.

a. The U.S. average retail price of beef during the second quarter of 1985 was $2.34/pound.

1) If retail prices had fully reflected the lower average steer price, they would have been down 17 cents from a year earlier and down 11 cents from the previous quarter.

2) This suggests less than full retail adjustment to live cattle price changes occurred.

3) It should b noted that after reaching a record level of $1.17 in July, the farm-to-retail spread narrowed to $1.14 during August.

b. The wider farm-to-retail price spread can explain $3.00-$3.50/cwt. of the year-to-year decline in choice steer prices.

c. As live cattle prices rise through the end of 1985, retail prices will likely lag behind, resulting in a narrowing of the farm-to-retail price spread.

B. Lower value of by-products, including hides, has contributed $1.00 to $1.50/cwt, of the year-to-year price decline in choice steer prices.

SLIDE 38: BEEF PRODUCTION IN 1986

	1986/85
A. Slaughter (35.0 - 35.5 mil)	-2 to -4%
Feds	-2 to -4%
Nonfeds	-2 to -4%
B. Weights (1070 - 1080 lbs)	-2 to -3%

1. More fed and less nonfed will keep upward pressure on slaughter weights

	1986/85
C. Beef Output (22 - 22.5 mil. lbs.)	-4 to -6%

1. First half -4 to -6%

   a. Fewer cattle placed on feed during third and fourth quarters of 1985.

   b. Slaughter of cows and nonfed steers and heifers will continue to drop.

2. Second half -6 to -8%

   a. Further declines in fed marketings during third and fourth quarters.

   b. Lower dressed weights

D. Imports

1. Near quota level

E. Beef/Person (Retail Weight)

1. Supply -5%

2. Population growth +1%

3. Retail weight 74-75 lbs.

   a. 1984 about 78.6 lbs.

F. Retail price /lb. for choice beef $2.36 - $2.42

1. Jan-June 1985 price was $2.37

2. July-Dec. 1985 price may be $2.30

3. Unlikely that retail prices will break through the $2.40 - $2.45 level in 1986; a resistance point for consumers in recent years.

SLIDE 39: CHOICE BEEF PRICES (DEFLATED) AND SUPPLY OF BEEF PER PERSON

A. Demand shifts for beef have been even more complex than pork.

1. Appears to be three different relationships (approximately):

   a. 1960-1968

      1) An "elastic" relationship; a given price change causes a more than proportionate change in quantity.

   b. 1969-1979

      1) A much less "elastic" relationship

      2) A shift outward of entire relationship; at a given quantity a higher price results

   c. 1980-85

      1) The least "elastic" relationship of the three; a given change in price hardly affects consumption.

      2) In addition, the entire demand schedule pivoted inward.

2. The recent shifts inward in demand may be associated with the same factors as affected pork demand:

   a. health and dietary concerns

   b. aging population

   c. geographic population shifts

3. The changing slope of the relationships, or their elasticity, may be due to the changing consumption patterns of families.

   a. As more women work outside of the house, away-from-home food consumption increases.

   b. People may not be as sensitive to price changes when eating away from home.

4. It is doubtful that beef demand will be become more "inelastic" in the future, but it is possible that further shifts inward of the relationship could occur.

SLIDE 40: STEER PRICES, 900-1100# CHOICE

A. Review of 1985

1. Jan.-Sept. '85 steer prices averaged $57.32/cwt., or $8.96/cwt. lower than during the same period of 1984.

   a. Steer prices were above the 5-year average only in January.
   b. During March through September, steer prices were below the 5-year low each month.

1) During the summer months, steer prices were $10.00 to $15.00 /cwt. lower than previous 5-year lows.

2) Prices averaged $52/cwt. for the third-quarter; the lowest third-quarter price since 1977.

c. As stated earlier, it was felt that these factors were responsible:

1) Increased live weights

2) Wider marketing margins

3) Lower by-product values

d. Prices are expected to strengthen during late fall as production declines.

1) Average $60-62/cwt. for the fourth quarter

2) Prices will likely return to moving in the range of prices for the previous 5 years.

B. 1986 prospects: first half of year

1. Beef output down 4 to 6%

a. Fed marketings may decline 7 to 9%, but heavy slaughter weights will limit production declines.

b. Nonfed slaughter will be reduced.

2. Prices are expected to continue in the low 60s during the first quarter, and rise to the mid to upper 60s during the second quarter.

C. 1986 Prospects: Second half of year

1. Beef output down 6 to 8%

a. Moderate gains in consumer income

b. 4% rise in poultry production will limit any price increases from 5% overall decline in red meat production.

2. Fed cattle prices may average $63-68/cwt.

SLIDE 41: FEEDER STEER PRICES: 600-700# KY. MED. NO. 1

A. Demand for feeder cattle is a derived demand with the principal components being consumer demand for beef and the supply cost of feed.

1. Continued liquidation of the breeding herd to maintain cash flow, low fed cattle prices, the reluctance of lenders and producers to assume the risks of feeding cattle have constrained feeder cattle prices.

    a. Kentucky feeder cattle prices averaged $62.29/cwt. in the first half of 1985, near the five-year average for the period.

    b. Feeder prices followed fed cattle prices and moved to the bottom side of the five-year range during the summer months.

B. 1985 calf crop is estimated at 41.1 million head, or 3.3% below 1984.

1. However, increased productivity has offset part of the drop.

    a. 88.9 calves born per 100 cows in 1985, compared to 87.4 in 1984.

2. Supplies of feeder cattle outside of feedlots on July 1, 1985 was estimated to be 4.7% below year earlier levels.

3. Expectations are that 500-600 pound feeders in Kentucky grading Medium No. 1 will average $62-68/cwt. during the fall of 1985.

C. Prospects for 1986

1. A turn-around in fed cattle prices and lower feed costs may support aggressive feedlot demand.

2. If herd liquidation ends and expansion begins during 1986, a further tightening of supply could strengthen feeder cattle prices.

3. Cow-calf producers in Ohio and the surrounding area have ample grass and stored hay and may hold feeders tightly.

4. Feeder cattle prices may average $63 to $69/cwt. for 1986.

ANSWER 9 -- DISAGREE

QUESTION 10--<u>Most participants in the government corn program should make modest profits on their 1985 crop</u>.

SLIDE 42: CORN: SUPPLY AND USE

A. Supplies for the 1985-86 marketing year will be 9.8 billion bushels, up 17% from last year

1. Acreage harvested for grain = 74.8 million, +4.2%

2. Average yield = about 115 bu./acre, +8%

    a. a new record high, topping 1982's 113.2 bu./acre average

b. in Ohio, 128 bu./acre, up from 115 bu. last year

3. Carryover on October 1, 1985 = 1.3 billion bushels, +82%

B. Use in 1985-86 is expected at around 7.0-7.1 billion bushels, little changed from 1984-85's 7.06 billion

1. Domestic use will increase modestly from last year's 5.2 billion bushels

2. Industrial demand, food and seed uses have expanded at an annual rate of nearly 10% over the past five years

a. should increase by 60-65 million bushels this year, somewhat less than in recent years

b. most of the increase associated with increased production of high fructose corn syrup

c. no major new market looms, such as the switch to corn sweetner in soft drinks over the past few years

d. capital commitment to expand ethyl alcohol production as an octane enhancer appears limited by:

1) low cost ethyl imports, mainly from Brazil

2) concern over negative public reaction in times of food shortages

3. Feed use may increase marginally, but no sizeable increase is likely

a. the number of grain-consuming animal units will remain nearly level

1) gains in poultry and dairy cattle numbers will be just about offset by declines in hogs and cattle on feed

b. average feeding rate may increase nominally in response to somewhat lower feed costs

1) but increase is limited by price support level

c. continued strong competition from wheat and other feed grains

1) particularly in the high plains of Texas and Kansas where the largest increases in cattle feeding have occurred

2) large competing supplies of feed wheat and grain sorghum

4. Exports will decline 10-15%, to around 1.6 billion bushels

a. will probably be the lowest since 1976's 1.68 billion and could even be lower

b. several reasons

1) continued relatively strong dollar

2) dramatic increases in world production of feed grains in the past two years, particularly in:

i) Western Europe
ii) China
iii) India
iv) South Africa
v) Thailand

3) an improved grain harvest in the Soviet Union, up about ten million metric tons to 180 million

4) increased competition from cassava (tapioca), primarily from Thailand

i) mixed 80-20 with soymeal, it replaces an equal weight of corn

ii) enters many markets, particularly the EC, with a much lower tariff than does corn

c. Corn carryout on September 30, 1986 is projected at 2.6 to 2.8 billion bushels

1) more than double this year's carry-in

2) second largest ever to the 1982-83 carryover of 3.1 billion bushels

3) large enough to keep prices in the doldrums

SLIDE 43: U.S. CONSUMPTION OF MEAT AND CORN FOR FEED

A. This shows the relationship between consumer incomes, meat consumption and the domestic use of corn as feed
B. In the 1960's and 1970's, higher real spendable incomes brought increases in both:
1. spending on meat

2. the quantity of meat consumed

C. This spilled over into profitable feeding conditions and increased demand for feedstuffs, particularly corn

D. So far in the 1980's, however, income increases have not generated increased meat consumption

1. spending on meat has actually declined.

2. more of the meat consumed is chicken, which requires less feed per pound than pork or beef

3. the result has been a downward shift in the domestic feed demand for corn

4. this has been further aggravated by increased wheat feeding

E. Thus, the outlook for further growth in domestic feed use of corn does not appear bright enough to solve the surplus production problem

SLIDE 44: CORN: STOCKS-PRICE/LOAN RELATIONSHIP

A. The size of year-end carryout stocks is the dominant factor in determining season average prices relative to loan rates

1. when carryout exceeds about 1-1.2 billion bushels, prices tend to average near the price support loan rate

2. carryouts of less than around 800 million bushels appear to be necessary to drive prices appreciably above loan rates

B. The 2.6 billion bushel or so expected carryout this year is not likely to change the pattern

1. because of early season low prices, the 12 month average may not reach the $2.55 loan rate

SLIDE 45: CORN: OHIO AVERAGE FARM PRICE

A. Last year we predicted a season average price for 1984-85 in the $2.65-$3.00 range

1. Actual average was $2.61

2. Average was pulled down by the sharp drop-off through last summer in anticipation of the record 1985 harvest

B. For 1985-86, we expect prices to average in the $2.30-2.55 range

1. A harvest low of $2.04 was recorded in October

2. Prices should begin to trend upward as the 1985 crop finds storage space

3. The up-side price potential is currently determined primarily by the CCC loan program

a. About 70% of the 1985 crop is eligible for loan at a national average of $2.55

1) this is equivalent to about 5.9 billion bushels that could be isolated from the market under nine month loans

2) if just 60% (low estimate) enters loan (3.5 billion bushels), some loan redemptions will be necessary to meet market needs (vs. carryout of around 2.6 billion)

3) with harvest prices around $2, incentive to put corn under loan is great

4. The question is, how high?

a. redemption values are loan rates plus interest plus some return to storage costs

b. loan rates in the western corn belt (Iowa) are roughly ten cents below Ohio (about $2.50 compared to $2.60 here)

c. interest is about 1.7 cents/bushel/month

d. this puts Iowa redemption values in the spring-early summer at about $2.58 plus whatever return to storage the producer is willing to accept

e. assuming some producers will settle for as little as one cent per bushel per month return to storage, this puts redemption prices in Iowa at roughly $2.65 for the April-May period

5. the eastern cornbelt price advantage over the western cornbelt has disappeared with the weak export market

a. thus, the spring price target for Ohio is roughly $2.65 as well

b. with a state average loan rate = $2.59 and 1.7 cents per month interest, this indicates little likelihood of a profitable loan redemption opportunity for Ohio producers

C. Will this be sufficient to return a profit to Ohio growers who participated in the 1985 government program?

1. Assume a $2.59 loan, 30 cents storage costs for nine months, and forfeiture of the grain at the end of the loan

a. net return is $2.29 from the loan

b. add to this a 48 cent deficiency payment

c. total return from government program = $2.77

2. Add in nearly riskless gain of 10-15 cents from the purchase and resale of an "at the money" May call option to benefit from price appreciation through spring

3. effective value per bushel is pushed to around $2.90

4. with average Ohio yield of 128 bushels per acre, this brings gross returns per acre to around $370

   a. assume $170 per acre for variable costs and $85-90 per acre for nonland fixed costs

   b. the residual of $100 or so per acre becomes net returns to land

   c. with average cash rents of something around $80, this generates a modest profit

ANSWER 10--AGREE

QUESTION 11--Soybean prices during the 1985-86 market year are "stuck" at the CCC loan rate.

SLIDE 46: SOYBEANS: SUPPLY AND USE

A. Supplies for the 1985-86 marketing year are around 2.4 billion bushels, up 18% from 1984-85

   1. Acreage harvested = 62.2 million, down 6%

   2. Average yields put at about 33.8 bushels per acre

      a. a new record high, besting 1979's 32.1 bushels

      b. up 20% from last year's 28.2 bushels

   3. Carryover on September 1, 1985 = 318 million bushels, up 81%

B. Use in 1985-86 is expected to total 1.8 billion bushels or a bit more, up about 6% from 1984-85

   1. Exports are running well ahead of the year earlier pace (up about 25% through the first two months of the market year)

      a. should total between 650 and 700 million bushels, up from 598 million last year (+10-15%)

         1) 1984-85 exports were down 19% and were 35% below the 1981-82 peak

      b. upturn reflects:

         1) a somewhat lower value of the dollar vis-a-vis currencies of soybean-buying countries

2) lower South American exports

3) lower soybean prices

4) a modest upturn in world animal numbers

5) more cassava feeding, particularly in western Europe and Japan which requires more protein supplement

2. Domestic crush should be about even with last year to nominally higher

a. mainly because soymeal demand has been strengthening due to its low price relative to corn

b. in 1984-85, soymeal:corn price ratio = 1.33

1) in the late 1970's and early 1980's it was 1.8 to 2.1

2) a ratio based on feeding value is in the 1.5-1.7 range

C. Carryout next August 30 is likely to be around 590 million bushels, up 85% from this year's carry-in

1. This will be the largest ever, topping the previous high of 358 million in 1980 by about 65%

SLIDE 47: SOYMEAL CARRYOVER AND PRICE

A. Soymeal stocks increased about 65% at the end of the 1984-85 marketing year

1. Exports were down 10%, reflecting

a. weak demand

b. aggressive South American competition

2. Domestic use increased nearly 10%, primarily in response to low prices

3. Prices had to be discounted to the lowest levels in more than a decade to find buyers for the larger crush

a. last year's 9% increase in crush was driven by an unusually strong oil market

B. Stocks will probably decline modestly this year

1. continued relatively low prices should stimulate both domestic and export demand

2. crush may increase marginally

C. Prices should push up toward $150 per ton by early spring

1. this would be roughly equivalent to about 1.7 times the corn price, or about in parity with relative feeding values

SLIDE 48: SOYOIL CARRYOVER AND PRICE

A. For the past two years carryover stocks have been at very low levels

1. This reflects reasonably strong export demand and a trend-line 2 percent per year increase in domestic demand

a. export demand was helped by disappointing production of other edible oils, mainly palm oil

2. This year export sales are expected to weaken by 8-10%, due to

a. recovered Malaysian palm production

b. record oilseed production in western Europe

1) mainly sunflower and rapeseed

2) but, soybeans are increasing rapidly--acreage in France and Italy has increased ten-fold since 1980

B. Carryout stocks will increase roughly 20% this year

1. This suggests that prices will probably average in the low 20 cent area (21-25 cents per pound)

2. however, oil prices are much more difficult to predict because of the wide array of edible oils that figure in the world market

SLIDE 49: 1985 SOYBEANS: A JOINT PRODUCT

A. Last year we said, a season average price in 1984-85 in the $6.00-6.50 range

1. Actual average was $5.80

B. This year, product values of

1. oil in the 21-25 cent range

2. meal in the $128-146 range (could be a bit higher)

3. yields a product value per bushel in the $5.31-6.17 range

4. from this, must deduct the crushing margin which is normally in the 20-40 cents range

5. this generates an expected market price for soybeans in $5.00-5.80 range

SLIDE 50: SOYBEANS: AVERAGE OHIO FARM PRICES

A. Prices have started out in 1985-86 below $5.00, closely paralleling the last big crop year in 1982-83

1. the entire crop is eligible for CCC loans at a national average of $5.02

2. with harvest prices well below loan, entries should be sizeable

3. thus, some loan redemptions appear necessary prior to the marketing of the 1986 South American crop (April-May)

4. minimum redemption prices in March-April are around $5.20 plus some return to storage costs

a. adding in three cents per month storage returns raises the redemption price to about $5.35 in the March-April period

5. with relatively strong export demand this winter, due primarily to the unavailability of South American supplies (they were sold out prior to the U.S. harvest), a realistic price expectation is above the $5.35 redemption value

a. perhaps in the $5.40-5.60 range, pre-plant

B. Post-planting, price trends will be determined by

1. size of the 1986 crop

2. weather prospects

3. marketing strategies by Brazil and Argentina

ANSWER 11--DISAGREE

QUESTION 12: Wheat Yields Around the World are Escalating Rapidly, Putting a "Damper" on U.S. Exports

SLIDE 51: WHEAT YIELDS

A. The slide shows the wheat yields for five countries--India, U.S., China, France, and England--from 1973-74 through 1984-85

1.

Country	73/74 Yield	84/85 Yield	Change
India	18.88	27.51	+45.7%
China	17.99	43.27	+240.5%
France	66.91	102.01	+52.4%
England	64.83	112.71	+73.8%
U.S.	31.67	38.81	+22.5%

2. Relative change in wheat yields is a limited measure of changes in physical production efficiency

   a. while recognizing the limitation, yield increases around the world suggest that the U.S. physical production advantage for wheat has declined

3. Implications

   a. the suggested decline in relative wheat production efficiency raises the question of whether U.S. wheat growers can generate sufficient exports to regain 1970s style prosperity, even if the dollar declines and stronger demand fundamentals reappear

   b. increasing wheat yields in other countries has put their agriculture in a more competitive position to respond to increases in worldwide wheat demand

SLIDE 52: WHEAT: SUPPLY AND USE

A. 1985-86 supply is 3.8 billion bushels, down 5% from last year's record level

   1. Production = 2.4 billion bushels, down 7.5%

      a. acreage = 64.6 million acres, down 3.4%

      b. average yield = 36.8 bushels per year, down 5.1%

         1) yield was third highest on record

         2) but, only 1.3% above five-year average

   2. Carry-in = 1.4 billion bushels, about the same as last year's

      a. second largest carry-in on record

      b. carry-in equals 62% of projected use for 1985-86

B. Projected use during 1985-86 = 2.2 - 2.3 billion bushels, down 10-15%

   1. Domestic use = 1.05 - 1.11 billion bushels, about the same as the previous year

      a. feed use will remain historically high--about 350 million bushels--but down from the record 412 million bushels fed in 1984-85

         1) wheat/corn price ratio will be up about 15%

         2) historically, have fed only 150-200 million bushels of wheat

3) wheat feeding supported by heavy shift of cattle to major wheat states of Kansas and Texas

2. Exports = around1.1 billion bushels, down 12 to 15%

a. since 1981-82 the U.S. has lost one-third of its share of worldwide wheat exports

b. reasons for the decline include:

1) strong U.S. dollar

2) high U.S. loan rate relative to world wheat prices

3) increased production in both importing and exporting countries

4) debt repayment problems in developing countries

5) use of export subsidies, particularly the European community

SLIDE 53: WHEAT: STOCKS-PRICE/LOAN RELATIONSHIP

A. Chart shows that when carryout exceeds about 1.1 billion bushels, season average price falls close to the loan rate

1. About 74% of 1985 crop is eligible for price support loans of a national average rate of $3.30 per bushel

B. 1985-86 carryout of about 1.5 billion bushels indicates a season average price below the loan rate

1. For Ohio, this suggests a season average price in the $2.80-$3.10 range

2. For those who participated in the 1985 wheat program, an additional $1.08 will be received in the form of a deficiency payment

SLIDE 54: WHEAT: OHIO AVERAGE PRICES

A. Last fall a season average price of $3.20-$3.40 per bushel was predicted

1. Actual Ohio average was $3.35 per bushel with little seasonal variation

B. Due to the large wheat crop and uncertainty surrounding future wheat programs, Ohio wheat prices moved sharply downwards over the June-September '85 period

1. During September, prices were 72 cents below the loan rate

C. Prices are expected to improve during the fall as the basis tightens and futures prices increase

D. Marketing recommendations

1. Use the loan when eligible

a. loan rate of $3.30/ bushel and target rate of $4.38/bushel

b. wheat prices will need to reach $3.50/bushel in order to redeem loans when interest at 7 3/4% is charged for nine months

2. Significant basis appreciation occurs for wheat during the October to May marketing period

a. based on current interest rates, basis appreciation may cover carrying charges

b. for wheat not under loan, check futures contract spreads for the best selling date

QUESTION 13--DECLINING LAND COSTS WILL MAKE WHEAT PRODUCTION MORE ATTRACTIVE COMPARED TO CORN

A. The slide shows production costs for a 600 acre Ohio farm for varying level of yields and rents

1. Land rent of $35 per acre is associated with 90 bushels per acre corn, 28 bushels per acre soybeans, and 30 bushels per acre wheat

2. Land rent of $70 per acre is associated with 120 bushels per acre corn, 38 bushels per acre soybeans, and 45 bushels per acre wheat

3. Land rent of $110 per acre is associated with 150 bushels per acre corn, 44 bushels per acre soybeans, and 60 bushels per acre wheat

4. Per bushel costs of production for each yield and rent combination are presented

a. variable costs

b. non-land fixed costs

c. land rent

B. Total cost of production is lower on the higher rent ground

1. Cost Differential Between Low and High Rent

   Corn $ .22/bu.
   Soybeans $1.09/bu.
   Wheat $1.11/bu.

2. This occurs despite increasing land costs on a per bushel basis

C. Two decisions need to be made based on the relationship between production costs and prices

1. whether to farm the land, or let it lay idle

2. if the land is to be farmed, what crops should be grown

3. if land is to be farmed, prices must equal or exceed non-land fixed plus variable costs for at least one crop

   a. lowest rent ground ($35/acre)

	Non-land Costs	Price
Corn	$2.43	$2.30-2.55
Soybeans	$6.15	$5.00-5.80
Wheat	$4.37	$2.80-3.10

      1) without government deficiency payments it is unlikely that such land would be farmed

      2) if the land was enrolled in the government program it is likely to only grow corn, and good management would be required to make a profit

   b. medium rent ground ($70/acre)

	Non-land costs	Price
Corn	$2.00	$2.30-2.55
Soybeans	$4.81	$5.00-5.80
Wheat	$3.17	$2.80-3.10

      1) price exceeds non-land costs for all crops without government deficiency payments

   c. highest rent land ($110/acre)

      1) price is greater than non-land costs

D. Relative profitability of alternative crops will determine the crop mix on land that will be farmed

	Price	Costs	Margin
1. Corn			
($70 rent)	2.42	2.67	-.25
($110 rent)	2.42	2.61	-.19
2. Soybeans			
($70 rent)	5.40	6.65	-1.25
(110 rent)	5.40	6.31	-0.91
3. Wheat			
($70 rent)	2.95	4.73	-1.77
($110 rent)	2.95	4.43	-1.48

4. Without government deficiency payments, wheat has by farm the largest losses

    a. only with deficiency payments is wheat competitive with corn and soybeans

    b. even if all land rents fall, wheat will not be more attractive than corn or soybeans

ANSWER QUESTION 13: DISAGREE

SLIDE 56: Supplies and Prices: 1986

A. See slide for summary

B. This will become next year's score card

QUESTION 14--Cash flow can be managed to meet farm and family needs

SLIDE 57: MANAGING CASH FLOWS

A. Some strategies that need to be considered relative to successful cash flow management

1. Postpone unnecessary farm and family expenditures

    a. may require modifying business, family living goals and objectives

2. Seeks ways to increase cash receipts

    a. market in a timely manner

    b. sell excess, unproductive assets

    c. off-farm earnings

3. Reduce cash operating expenses

a. hold the line on borrowing

b. calculate earnings per dollar spent before spending

c. delay capital expenditures where possible

3. Reschedule debt repayment

4. Manage taxes carefully

a. take advantage of loss provisions

b. avoid "back tax" liabilities in liquidation of depreciable assets

5. Consider selling land, custom hire, culling livestock

a. sales - lease back arrangements on land can reduce cash flow requirements to service land debt

b. custom hire may reduce needed capital equipment

1) hiring out on a custom basis may increase revenue without jeopardizing your farming operation

c. cull livestock that are not generating sufficient income to cover out-of-pocket costs

B. Survival

1. Plan around your management and financial strengths

a. reduce or eliminate those activities or enterprises that are marginal

b. Concentrate on what you can do best with the resources (land, labor, fixed investment) that you own or control

2. Manage effectively

a. optimize production efficiency, e.g. maximize output per dollar invested

b. be alert to innovative financial strategies

1) effective cash management--do not let it stand idle (pay interest-bearing bills or invest in short-term deposits)
2) outside equity/risk-sharing capital

c. Develop, maintain and use a marketing plan

SLIDE 58: PRICING THE 1985 CORN CROP

A. This illustrates some pricing options for the 1985 corn crop that could be considered in a marketing plan

B. The same options apply to next year's crop and crops thereafter

1. although details of such things as the Acreage Reduction Program (ARP) and CCC loans may vary

C. Marketing requires constant and skillful attention

1. know production costs

2. set realistic pricing, profit objectives

a. not local "bragging rights" for hitting the top of the market

3. learn how seasonal price patterns are affected by such things as:

a. crop size

b. weather

c. government programs

4. study your local basis patterns

5. establish trigger points for sales

a. "scale-up" rather than "wait-for-the-peak"

6. implement the plan

a. make cautious modifications as market conditions change

b. rationalize modifications with evidence of weaknesses in original plan

SLIDE 59: DIVERSIFIED PRICING PLAN FOR SOYBEANS

A. This is a hypothetical example, but the basic principles are valid in many situations

1. each person must decide the appropriate percentages for pricing at each point

B. Uncontrollable factors are:

1. Future price trends

a. uncertain

b. likely to increase

c. likely to decrease

2. Strategic variables--when and how to price

1. preplant

2. preharvest

3. harvest

4. post-harvest

a. winter

b. spring

D. Many other variations possible

1. Tailor the plan to your business circumstances

2. devote the time necessary to do a good job

ANSWER 14--AGREE